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Revision of the wording of article 26 of the United Nations Model Double Taxation Convention between Developed and Developing Countries*

Summary

The present paper presents the position of the subcommittee concerning the revision of article 26 of the United Nations Model Double Taxation Convention between Developed and Developing Countries. It takes the changes to the OECD model as a starting point (as recommended by the Committee of Experts on International Cooperation in Tax Matters) and takes into account the commentaries made at the first session of the Committee, in December 2005, and the work of subcommittee members. The intention of the present paper is to give the Committee all relevant information so that it may decide at its second session on the changes to be made to article 26 of the United Nations model.

* The present paper was prepared by the subcommittee on exchange of information (Coordinator: José Antonio Bustos Buiza); the views and opinions expressed are those of the author and do not necessarily represent those of the United Nations.

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I. Introduction

1. In July 2005, article 26 on exchange of information of the OECD Model Tax Convention on Income and on Capital (OECD model) was amended with the purpose to widen its scope and coverage. The Committee of Experts on International Cooperation in Tax Matters, at its first session, in December 2005, appointed a subcommittee of experts with the mandate to consider the possible revision of article 26 of the United Nations Model Double Taxation Convention between Developed and Developing Countries and its commentary in the light of the changes made to article 26 of the OECD model. The subcommittee was guided in this task by the work of the Committee, which was based on a paper prepared by David Spencer.

2. The present paper describes the position of the subcommittee concerning the revision of article 26 of the United Nations model. It takes the changes to the OECD model as a starting point (as recommended by the Committee) and takes into account the commentaries made at the first session of the Committee, in December 2005, and the work of subcommittee members.

3. As a preliminary remark, the subcommittee is of the opinion that no changes should be made to the commentary of article 26 before an agreement is reached upon the wording of the same. The main issues related to these changes, as reported in the report of the Committee, are as follows:

(a) The term "foreseeably relevant" versus the term "necessary";

(b) Taxes covered;

(c) Disclosure to oversight bodies;

(d) Domestic tax interest;

(e) Bank secrecy;

(f) Dual criminality requirement;

(g) Automatic exchange of information.

II. Revision of the wording of article 26 of the United Nations model

A. The term "foreseeably relevant" versus the term "necessary"

4. The term "necessary" in paragraph 1 of article 26 of the 2003 OECD model was replaced by the term "foreseeably relevant" in the 2005 version. The commentary of the article (para. 5) indicates clearly that the intention was to broaden "to the widest possible extent" the scope of exchange of information between Contracting States. However, the commentary defines two limits to this scope: Contracting States may not (a) engage in "fishing expeditions" or (b) request information that is "unlikely to be relevant to the tax affairs of a given taxpayer".

5. The term "necessary" may be considered as an undefined, confusing and ambiguous term. That is why the proposed wording uses the term "relevant" instead

of the term "necessary". Therefore, the first sentence of article 26 of the United Nations model would read as follows:

> "The competent authorities of the Contracting States shall exchange such information as is **relevant** for carrying out ...".

6. The wording of the OECD model (i.e., foreseeably relevant) because of the term "foreseeably" may create some confusion and ambiguity when it comes to the implementation of the provision, especially since the commentary (para. 5) did not clearly present the rationale of this amendment.

7. In addition, the term "relevant" offers a reasonable guarantee of the effectiveness of the exchange of information, particularly if we bear in mind that a Contracting State may not oppose, under the proposed new paragraph 5 of article 26, the absence of a domestic interest to decline a request from the other Contracting State.

8. Members of the subcommittee prefer the term "may be relevant" rather than the term "relevant" because they understand that this term is broader and more in keeping with the asserted goals of article 26. The term "relevant" may allow the requested State to refuse to provide information absent a showing by the requesting State that the information is relevant for the purposes specified in paragraph 1. Allowing that type of delaying tactic seems unwise in the extreme. If agreement cannot be reached, alternative language and reasons for it could be noted in the commentary.

9. A member of the subcommittee recommended that the words "and combating tax avoidance" be added after the words "preventing fraud or evasion of such taxes". This additional language could be important to many developing countries and is consistent with the goal of international tax treaties. A major objective of a tax treaty, from the perspective of a developing country, is to combat tax avoidance. In addition, the line between aggressive tax avoidance and tax evasion is almost always unclear until the facts of the case are fully developed.

B. Taxes covered

10. The 2005 revision of the OECD model extended the scope of article 26 to "*taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities*". Therefore, a Contracting State may request from the other Contracting State any (relevant) information, whether it concerns taxes covered by the convention or other taxes.

11. The proposal therefore introduces a similar amendment to paragraph 1 of article 26 of the United Nations model. Although such an amendment may cause an additional burden to tax authorities in developing countries, it will allow an exchange of information on important taxes that are not usually covered by the treaty, such as VAT and other consumption taxes, registration duties etc. Information on these taxes may be relevant for the taxes covered by the treaty (e.g., income tax).

12. As to the form and structure of article 26 of the United Nations model, the proposal splits off paragraph 1 thereof in two paragraphs (1 and 2) in the same way as what has been done in the OECD model, to renumber paragraph 2 to become

paragraph 3 and to correct the cross-reference in paragraph 3 (previously para. 2) as follows:

> "3. In no case shall the provisions of **paragraphs 1 and 2** [instead of paragraph 1]...".

13. A member of the subcommittee also suggested that the exchange of information not be extended in the model convention to all taxes, including subnational taxes, but should be extended to include the VAT. This suggestion is given in the commentary. In that case, the United Nations model could have only the VAT in the model convention itself, with the broader alternative provided in the commentary.

C. Disclosure to oversight bodies

14. New paragraph 2 of article 26 of the 2005 OECD model provides that exchanged information may be disclosed to oversight bodies.

15. Such a provision may pose a serious risk of (undesired) disclosure of the information obtained under article 26, as there might not be effective guarantee that the information disclosed to the oversight body will not be released to other parties, which, in principle, are not entitled to have access to such information.

16. Therefore, the proposal does not incorporate an amendment to article 26 of the United Nations model similar to the amendment made to article 26 of the OECD model mentioned above.

D. Absence of domestic tax interest

17. A new paragraph (para. 4) was added to article 26 of the OECD model in its 2005 version. This paragraph provides that:

> "(i)f information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the previous sentence is subject to the limitations of paragraph 3 [i.e., paragraph 2 in the United Nations model] but in no case shall such limitations be construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information."

18. This paragraph offers an important guarantee as to the effectiveness of exchange of information between Contracting States, as these may not avoid the obligation to provide information under article 26 on the grounds that they have no (tax) interest in the requested information. This, however, should not mean that a Contracting State must provide the requested information regardless of its capacity or of the cost that it may incur to do so. This is an important issue particularly for tax authorities in developing countries. The obligation contained in the proposed paragraph 4 should be tempered to take into account the capacity and (material and human) resources of the competent authorities of the requested State.

19. Accordingly, the proposal includes wording to charge the requesting party with any "extraordinary costs" incurred in providing the requested information.

20. Therefore, the proposal adds a paragraph 4 to article 26 of the United Nations model, drafted in the same way as paragraph 4 in the OECD model (see above) and providing for the following at its end:

> "Extraordinary costs incurred in providing information shall be borne by the Contracting Party which requests the information. The competent authorities of the Contracting Parties shall consult with each other in advance if the costs of providing information with respect to a specific request are expected to be extraordinary."

21. Members of the subcommittee are troubled by the suggestion that the requested party would be able to require the requesting party to bear so-called "extraordinary costs", especially when the requested party is a developed country because the potential for abuse could be high. This issue is of particular significance in the case of so-called de facto bank secrecy. If a Government has gone to some trouble not to have information to exchange, it can easily assert that the cost of obtaining it on request is high. In most cases, however, the cost would be negligible if the Government had acted in good faith in the beginning and had not tried to avoid its obligation to exchange information.

E. Bank secrecy

22. A new paragraph (para. 5) was added to the OECD model in 2005. It reads as follows:

> "In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institutions, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interest in a person".

23. This is one of the key amendments introduced by the 2005 revision of the OECD model. The intention here (according to the commentary of the article (para. 19.10)) is to prevent Contracting States to use the limitations provided for in paragraph 3 as a basis for declining requests of information held by banks, financial institutions, nominees, fiduciaries etc. or information related to ownership.

24. The commentary of the article (para. 19.10) also states that the addition of paragraph 5 "*merely reflects current practice*", as most of the OECD member States override bank secrecy and exchange the type of information mentioned above. Therefore, paragraph 5 should not be interpreted as introducing an additional obligation that did not exist under the previous version of the OECD model. Accordingly, the proposal adds a paragraph 5 to article 26 of the United Nations model drafted in the lines of the same paragraph in the OECD model.

25. A member of the subcommittee emphasized that paragraph 5 should be interpreted restrictively, i.e., only regulations relating to bank secrecy and similar requirements (of fiduciaries, nominees etc.) may be overridden. Information held by lawyers, notaries and other legal professionals that is protected by professional secrecy laws and regulations should continue to be covered by paragraph 3, and thus a Contracting State may decline a request to disclose such information. This is reflected in the commentary of paragraph 5 (end of para. 19.14). To reflect the clarification made in the previous paragraph regarding protection of information

held by lawyers and other legal representatives in the text of the article. To this end, the proposal could endorse the proposal made in the commentary of paragraph 3 in the OECD model (para. 19.4) to add a subparagraph (d) to paragraph 3 of article 26 drafted as follows:

> "(d) To obtain or provide information which would reveal confidential communications between a client and an attorney, solicitor or other admitted legal representative where such communications are:
>
> (i) Produced for the purposes of seeking or providing legal advice; or
>
> (ii) Produced for the purposes of use in existing or contemplated legal proceedings."

An alternative wording proposed by other members of the subcommittee based on the OECD commentary (para. 19.3) could be:

> "(d) To obtain or provide documents that would reveal confidential communications between a client and an attorney, solicitor or other admitted legal representative acting solely in that capacity where such documents:
>
> (i) Are protected from disclosure under the domestic law of the requested State;
>
> (ii) Were produced either for the purposes of seeking or providing legal advice or for the purposes of use in existing or contemplated legal proceedings;
>
> (iii) Were not delivered to an attorney, solicitor or other admitted legal representative in an attempt to protect such documents or records from disclosure required by law.
>
> Nothing in this subparagraph (d) shall protect documents from disclosure if the attorneys, solicitors or other admitted legal representative were not acting in their capacity as such but instead were acting in a different capacity, such as nominee shareholders, trustees, settlors, company directors, accountants or under a power of attorney to represent a company in its business affairs. Nor shall this subparagraph (d) protect documents from disclosure if the legal representatives have themselves participated with their client in a plan to commit tax evasion or fraud."

26. Other members of the subcommittee would prefer not to have such a subparagraph (d) in the article but do not object to the matter of the lawyer-client privilege being addressed in the United Nations commentary (language could be based in large part on para. 19.3 of the new OECD commentary on article 26).

F. Dual criminality requirement

27. The laws of some countries provide that information related to a criminal matter may not be exchanged unless the alleged violation constitutes a crime under the laws of both requesting and requested State. Such a provision is referred to as "dual criminality requirement".

28. A recommendation made by Mr. Spencer and supported by the Committee was to add a paragraph 6 to article 26 of the United Nations model with the purpose of

overriding the dual criminality requirement. Paragraph 6, which has no equivalent in the OECD model, would read as follows:

> "6. A Contracting State shall exchange information with the other Contracting State pursuant to this Article without regard to whether the conduct being investigated would constitute a crime under the laws of that Contracting State if such conduct occurred in that Contracting State."

29. Although this new paragraph is included in the proposal, membe of the subcommittee considered that a problem only arises with dual criminali those treaties that provide that information will be exchanged only with resp to "tax fraud and the like". The issue concerns which country gets to decide that the situation involves tax fraud. Therefore, including this provision could cast doubt on the interpretation of tax treaties that do not include such language. Therefore, if we do want to include such language, something could be added into the commentary stating that we are including it only out of a surplus of caution and no negative implications are intended with respect to treaties that do not include such a provision. Possible language to be included in the commentary could be the following:

> "The United Nations model convention does not require the existence of criminal activity in either of the Contracting States for the obligation to exchange information to arise. This article is included primarily to deal with those limited number of treaties where criminal activity in the requested State is required under the terms of the treaty. It is also included, as a cautionary measure, to ensure that a requested State cannot use th absence of criminal activity in one or the other State to avoid its o gation to exchange information under article 26."

G. Automatic exchange of information

30. An automatic exchange of information can only be beneficial to the effectiveness of exchange of information between Contracting States. To be effective, an automatic exchange of information should be preceded by coordination between Contracting States as to taxpayers' identification numbers.

31. It should be noted, however, that the effectiveness of automatic exchange of information depends heavily (as mentioned in Mr. Spencer's paper) on the existence of an effective (automatic) reporting system in the concerned Contracting State. This poses (again) the issue of the capacity of tax authorities in developing countries to handle such a reporting system. Indeed, setting up such a system presupposes at least the following:

(a) Coordination between the different stakeholders involved in cross border payments (taxpayers, financial institutions and authorities, tax department etc.);

(b) The capacity of the tax department to enforce the reporting requirement and to process and analyse the collected information.

III. Conclusion

32. Based on the analysis set out above, the subcommittee proposes to amend the wording of article 26 of the United Nations model as follows:

"Article 26
"Exchange of information

"1. The competent authorities of the Contracting States shall exchange such information as is **relevant/may be relevant** for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws **concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities**, insofar as the taxation thereunder is not contrary to the Convention, in particular for the prevention of fraud or evasion of such taxes **and combating tax avoidance**. The exchange of information is not restricted by Articles 1 **and 2**.

"2. Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State. However, if the information is originally regarded as secret in the transmitting State, it shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to the taxes referred to in paragraph 1. Such persons or authorities shall use the information only for such purposes but may disclose the information in public court proceedings or in judicial decisions. The competent authorities shall, through consultation, develop appropriate conditions, methods and techniques concerning the matters in respect of which such exchanges of information shall be made, including, where appropriate, exchanges of information regarding tax avoidance.

"3. In no case shall the provisions of paragraphs 1 **and 2** be construed so as to impose on a Contracting State the obligation:

(a) To carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

(b) To supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

(c) To supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy (ordre public);

"4. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case shall such limitations be

construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information. Extraordinary costs incurred in providing information shall be borne by the Contracting Party which requests the information. The competent authorities of the Contracting Parties shall consult with each other in advance if the costs of providing information with respect to a specific request are expected to be extraordinary.

"5. In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

"6. A Contracting State shall exchange information with the other Contracting State pursuant to this Article without regard to whether the conduct being investigated would constitute a crime under the laws of that Contracting State if such conduct occurred in that Contracting State."